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**REPORT**

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Departing Branch Chief Piatoff Discusses Recent Changes To APA Program, Recommends Against Joint Committee Review

Requiring the Joint Committee on Taxation to review advance pricing agreements, as the Senate Finance Committee recommended in a recent draft report, could discourage companies from seeking APAs, says Mindy Piatoff, who departed the Internal Revenue Service's APA Program in July. In light of recent changes to the APA process, including increased specialization, the former official discusses the need to balance consistency with other concerns. Piatoff, who will join the firm Sheppard, Mullin, Richter & Hampton LLP later this month, also tells how different directors have affected the program and which countries have expressed a growing interest in APAs.

Director's Role

BNA TAX MANAGEMENT: The APA Program has changed both under different directors and as business practices have evolved over the years. As someone who has served under two leaders of the program and as acting director during nearly the year between them, how do you feel each of you affected the program?

PIATOFF: Each of us has made a significant contribution. However, none of it would be possible without the staff and managers, who, with a diversity of strengths and skills, work together to make the program a success. The program has an extremely dedicated group of individuals who believe strongly in what they do and continually strive to improve the process.

Sean [Foley, APA Program director from March 2000 to October 2003] achieved the goal of reducing team leader inventory to an average of 10 cases and hiring enough economists to staff all APAs. Stuart Brown,

then Chief Counsel, gave Sean the ability to hire a number of team leaders, branch chiefs, and economists to accomplish these goals. Sean also worked with the staff to develop the APA training program to codify practices and provide new staff with the knowledge needed to handle cases.

We proved the success of staff-level increases the following summer of 2002 in a study prepared for the Internal Revenue Commissioner.¹ The report reflected the increase in productivity by team leaders and the decrease in time to complete cases. The percentage of the program's cases pending in competent authority increased from 33 percent to 67 percent, reflecting much quicker turnaround time, and new cases were in inventory for an average of just 12 months. This was the best

¹ The study was cited by Sean Foley in an October, 2002 interview (11 *Transfer Pricing Report* 567, 10/16/02).

proof that adequate levels of quality staffing keep cases moving and enable completion on a timely basis.

When I took over as acting director I sought to enhance our relationship with the Field and Competent Authority, to continue to respond to taxpayers, and to improve staff morale. The relationship with the Field in some parts of the country needed attention. By listening to the Field's concerns and being sure to ask their opinion, the staff and I were able to develop a level of trust. We worked closely with Competent Authority to ensure we were providing them what was needed. Open lines of communication with the staff were a top priority of mine and cases were assigned to team leaders based upon their skills and interest level.

Matt [Frank, hired as director in August of 2003] has led the program through a very difficult time. He handled the Senate Finance Committee requests² and has worked tirelessly, with advice from the staff, to develop ideas to improve the program without sitting back and waiting for the results. This led to the hearings on the APA Program in February and the APA initiatives announced recently (13 *Transfer Pricing Report* 943, 2/2/05; 13 *Transfer Pricing Report* 1023, 3/2/05).

BNA TAX MANAGEMENT: What are the biggest pitfalls for a team leader in processing an APA, and how can they be avoided?

PIATOFF: The biggest pitfall for team leaders right now is case inventory. I see the frustration in team leaders and I felt it myself. No one likes telling a representative that his or her case has to wait yet again before a team leader can start it or move it forward. However, review of the team leader's schedule reflects that there is no alternative. To help out, I drafted several APAs once there was a mutual agreement so the case could be completed immediately instead of waiting until the team leader was available. This didn't resolve the team leader's frustration but it helped manage timeliness.

BNA TAX MANAGEMENT: Besides the obvious answers of timely submitting and reviewing documents, what can APA personnel and taxpayers do to improve the APA process?

PIATOFF: Communication is critical. It is important for both taxpayers and the APA team to let the other side know as soon as possible if the case plan needs to change. When a taxpayer won't have its responses ready on time, if the team leader knows, he or she can at least shift priorities and turn attention to another case depending on the length of the delay.

BNA TAX MANAGEMENT: What do you see as the biggest challenges facing the program overall right now?

PIATOFF: The immediate challenge is dealing with the unknown: waiting for the Senate Finance Committee report. Once the report is issued, the challenge may be implementing changes that are intended to advance the goals of the program. Hopefully, the benefits will far outweigh the cost and impact of the changes. I know the committee shares this as a desired objective.

² The Senate Finance Committee in December 2003 launched an inquiry into whether APAs were being used as tax shelters. As part of the review, the committee asked the IRS to turn over more than 400 APAs and their underlying documents completed during the last 10 years (12 *Transfer Pricing Report* 711, 1/7/04).

Senate Finance Committee Review

BNA TAX MANAGEMENT: Of the recommendations contained in the draft report, which do you think would be helpful to the program (14 *Transfer Pricing Report* 154, 6/22/05)?

PIATOFF: The staffing incentives and ability to hire would be most helpful. It is important to attract quality people to the program but at the same time it is important to retain current staff. Since it has become common to hire branch chiefs from outside, it is important to ensure there are other opportunities for promotion within the program, such as senior counsel positions. Also, when hiring, in addition to technical transfer pricing experience, it is important for people to have good negotiating skills and the ability to work well with a team.

BNA TAX MANAGEMENT: Would any of the recommendations be problematic, and if so, how (14 *Transfer Pricing Report* 223, 7/20/05)?

PIATOFF: The most problematic would be the possibility of Joint Committee review. Not only could it stop companies from coming into the program, it might also prove to be impractical to require review for cases with rollbacks and those where there is Field disagreement. One of the goals of the program is to reach consensus with the Field. In the few cases where agreement can't be reached it is noted in the Director memo. However, the potential for Joint Committee review where Field disagreement exists and the committee's focus on bottom-line results could compel the Field to disagree to avoid being viewed as giving up potential revenue.

This would defeat the purpose of the program to reach consensus and resolve cases by determining the correct arm's-length result, not the result that yielded the most money for the IRS.

The Finance Committee also recommends inviting 'all relevant parties to the same factual development/negotiating table.' Many of our treaty partners might not agree to this process. If Competent Authority had adequate staff, there would be significant improvement. The competent authority analyst is a member of the APA team and generally attends all meetings. However, as their case inventory has grown (especially for the senior analysts who attend negotiations) this has become difficult. It is critical to have the analyst's perspective right from the initial meeting. The procedures are in place. With the right staffing levels the program works efficiently and as intended.

For instance, it is important for the competent authority analyst to advise the APA team about whether the treaty country has an opinion about the proposed method or its application. The better informed the team is about the likely reaction of the treaty country, the better the negotiating position will be since it can include alternative negotiating strategies.

BNA TAX MANAGEMENT: Has the review had any impact on the program?

PIATOFF: The additional work of fulfilling their requests has competed with the scarce staff resources and, in turn, caused delays in case processing.

New Procedures

BNA TAX MANAGEMENT: What do you see as the benefits—or drawbacks—of the new APA case management procedures whereby missed target dates trigger

consequences, such as having to submit a status report and eventually even having the case elevated beyond the taxpayer and the APA team's control (14 *Transfer Pricing Report* 225, 7/20/05)?

Do you think the new procedures are likely to result in faster case processing or just more realistic agreed deadlines?

PIATOFF: To the extent possible, case plans will set more realistic agreed deadlines. But, to the extent these deadlines are insufficient, the requirement is likely to result in time-consuming explanations. That time might be better spent working the case.

BNA TAX MANAGEMENT: As IRS Chief Counsel Donald Korb acknowledged in announcing the changes to the APA Program, practitioners said they were concerned about increased specialization in the program leading to a one-size-fits-all approach among industries or types of APAs (14 *Transfer Pricing Report* 3, 5/11/05).

Are those concerns well-founded? What can taxpayers and APA personnel do to ensure that does not happen?

PIATOFF: In my mind, there is no such thing as a one-size-fits-all approach. If a case is part of a group there is usually discussion about how it fits within the group and generally the taxpayer and its representative are actively part of the discussion. If a case comes into the program after development of the approach there is still a process to determine if the proposed method, although different, is reasonable. If so, the alternative approach will be accepted and again, the representative should be part of that discussion.

BNA TAX MANAGEMENT: Does the team consider precedent set in other APAs?

PIATOFF: Yes. If APAs in similar industries or with similar functions, risks and/or intangibles were completed, team leaders will consider these cases for guidance. However, although these similar cases would provide information, they wouldn't dictate a result.

BNA TAX MANAGEMENT: How much specialization actually took place on an informal basis—that is, to what extent are the new procedures formalizing current practice?

PIATOFF: Rather than specialization, I would call it coordination. This occurred for intangibles cases, consignment cases, auto parts cases, and, obviously financial product cases. These discussions included team leaders, economists, and competent authority analysts. This has always been important because Competent Authority has to be as consistent as possible when negotiating with the treaty country to retain its integrity.

BNA TAX MANAGEMENT: What concerns led the program to develop the annual report summary form?

PIATOFF: This was not the result of any concerns. It grew out of an attempt to expand the annual report database to track additional information.

Small Taxpayer APAs

BNA TAX MANAGEMENT: Do you feel the changes the IRS plans to implement as a result of the hearings on the APA Program will address everything that needs to be addressed? Are there any areas for improvement that were overlooked by either the Senate Finance Committee or Korb?

PIATOFF: A plan for addressing small business and small transaction cases still needs to be developed. The APA Program is very important to these taxpayers that attempt to follow appropriate pricing strategies but either can't reach agreement with the local Field team or merely want the certainty of an APA. My first experience with an APA as a practitioner was bringing several small-transaction taxpayers into the program. It was positive for both the taxpayer and the IRS. The benefit of the APA Program has always been its ability to take a practical business approach and focus on the big picture of reaching the appropriate arm's-length result.

If this group of taxpayers were handled separately, procedures could be developed that satisfy the program's due diligence but don't result in unnecessary review. There is an issue of materiality in these cases that must be recognized. A practical approach reaches the same arm's-length result.

For instance, with smaller-dollar cases, we generally do not need to segment divisions—the additional burden will not reach a better result. It would be better to develop a percentage of sales (or costs, whatever measure is applicable) beyond which additional detail is meaningful.

I also think it is crucial for the APA team to keep an open mind. This is true in all cases but specifically with these small business/transaction taxpayers. These taxpayers have the opportunity to play the audit lottery but instead choose to voluntarily seek protection by getting an APA. Team leaders can narrow information requests to require only documentation confirming that the business' transfer pricing method produces arm's-length results. After all, the small business/transaction procedures require the APA Program to provide special assistance to these taxpayers, not to make the process more burdensome.

Consistency

BNA TAX MANAGEMENT: Practitioners at the hearings in February complained that similarly situated taxpayers sometimes receive different treatment depending on whether the case is U.S.-parented or foreign-parented—something they said was a problem with other tax authorities as well. This was not something Korb addressed directly. Does the IRS discriminate between inbound and outbound taxpayers?

PIATOFF: From my personal experience there is no discrimination. Every case I reviewed was from the perspective of the appropriate result. There were times I wasn't very popular because I had to compromise at the competent authority level to be consistent with positions in other cases but it was the right result for the particular case.

A concern I had when I was acting director was cost sharing buy-in cases. At that time, I asked [team leader] Robert Weissler to coordinate these cases to ensure they were being handled similarly and methods were being used consistently whether the transaction was inbound or outbound.

BNA TAX MANAGEMENT: What is the IRS learning from its experience with industries, and how is this knowledge being used in other areas? For example, do you expect the settlement guidelines being prepared by IRS Director, International Robert Green will reflect discussions and knowledge gained from APAs on these issues? (See the related article in this section.)

PIATOFF: The APA Program has always had the unique ability to see Section 482 in practice. Other IRS offices, and Branch 6 of International in particular, request advice on various projects. For instance, APA economists and team leaders participated on the services regulation project and are participating on the cost sharing regulation project. Our economists sometimes provide input on certain valuation issues, and we recently consulted on an excise tax issue involving a maquiladora.

I understand Robert Green consulted with the APA office regarding our experiences for the cost sharing settlement project but I'm not aware of the specific issues addressed.

Expanding Interest

BNA TAX MANAGEMENT: Are any countries showing an interest, or an increased interest, in APAs that have not sought the agreements in the past or that have sought few APAs previously? If so, to what do you attribute the increased interest?

PIATOFF: France and the United States are interested in increasing the number of APAs between the two countries and the Competent Authorities are working to streamline the process. Also, now that Japan and China have completed the first APA, the United States would like to work with China on an APA.

BNA TAX MANAGEMENT: How is the West Coast office working out? Has it helped to have people actually 'on the ground' there? Are people in that office handling a greater portion of the cases from taxpayers west of the Mississippi?

PIATOFF: With the recent hire of a new economist, the West Coast office now has three team leaders and two economists. As the office continues to staff up it is able to handle a larger inventory of cases and is able to accommodate more taxpayers west of the Mississippi. Having people 'on the ground,' especially along with Competent Authority's California office, makes the APA Program much more accessible and efficient for West Coast taxpayers.

Disclosure

BNA TAX MANAGEMENT: Updates to the APA training materials—first released in 2001, when Sean Foley was director of the program—have been relatively few as of late, and Korb has said that 'disclosure of APA "guidance" or "policies" would not be consistent with the APA Program's mission, which is to resolve cases, not make policy.' Does this mean the program is unlikely to release any further training materials?

PIATOFF: As a result of significant time spent to respond to Senate Finance Committee requests and work on initiatives, there have not been enough resources to produce any significant updates or additions to the training materials.

BNA TAX MANAGEMENT: Are taxpayers better served with more or less disclosure?

PIATOFF: I understand the public likes disclosure because it provides a certain comfort level to know how APA 'policy' applies to other similarly situated taxpayers. However, we already spoke about concerns that a one-size-fits-all approach isn't practical. Understanding how transfer pricing affects me as a taxpayer is more important than disclosure.

What is most worthwhile is for a taxpayer to be able to speak with the APA Program directly about its specific facts and circumstances. This is one of the real benefits of an APA prefiling conference, especially the ability to come into the program anonymously.

As a practitioner from a boutique accounting firm (representing U.S. subsidiaries of Italian parent companies), I was impressed that I could speak to APA staff members about my clients' issues. It didn't matter that I wasn't from a D.C. law firm or a Big Four accounting firm. I still had access to the process and was able to meet the needs of my client. The program truly serves the public when it provides information to taxpayers. To the extent a taxpayer voluntarily uses the APA Program to ensure its transfer pricing is arm's length, the taxpayer gets certainty. In turn, the government is likely to get a more favorable result using fewer resources than would be possible either from Appeals or litigation.

By MOLLY MOSES